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Capacity Markets in the PJM Region
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We have been invited here today to discuss the capacity situation in the PJM RTO and to provide additional information to the Federal Energy Regulatory Commission and state public utility commissions that will assist them in providing guidance to the industry on the issues and perceived problems that may exist in the capacity construct currently in use.

I represent the views of my company and members of the PJM Public Power Coalition. The Coalition is made up of Municipal, Cooperative and Investor-Owned Load Serving Entities operating in the PJM footprint. My company and many of the Coalition members are also generation owners and transmission owners. I currently serve as the Chairman of the PJM Member's Committee, the principal stakeholder governance body of PJM, and the PJM Public Power Coalition is an active participant in the governance process at PJM. We are very supportive of the excellent staff at the PJM Interconnection.

Electric Supply is an integrated system of many moving parts. Rather than discuss "markets", we should focus on the integral parts of that system and how they function together to accomplish the work of the system. The system cannot be improved by working on one part at a time in isolation, but must be analyzed and improved as an integrated system. No amount of greasing of one part will improve the system if other parts of the system are not working properly. And it goes without saying that one must work on each part at the correct time. To work on a part that is not broken while ignoring a broken part in unwise. And I submit that we have some unwise actions occurring in the Electric Supply System.

Goals of a Capacity Construct:

- To assure an appropriate level of investment in the optimal mix of generation capacity within the system to assure availability of supply and reliability given the long lead times of construction; and
- To ensure the ability of the system to meet demand, given its inherent fluctuation and uncertainty and the non-storability of power; and
- To encourage a robust long-term bilateral forward market for power supply for long-term price stability insurance

To answer the question of whether or not the current capacity construct, in conjunction with the other parts of the integrated system, meets the above goals currently, one need only look at the incredible amount of new capacity built in the PJM footprint in the last seven years. I cannot arrive at any conclusion other than the current system is sufficient to encourage investors to

conclude that capacity, energy and ancillary services revenues from new generation assets would be sufficient over the long term to provide a higher rate of return than other available investments. Certainly, there is no need for an exit strategy from a working capacity construct. However, one failing of the current integrated system is its inability to encourage the correct mix of generation assets for the long term. Most of the new assets built have been smaller-scale natural-gas fired intermediate and peaking generation assets. What is long overdue and sorely needed is investment in new base loaded large-scale generation assets utilizing economic and abundant fuels. Why has that not happened? It is certainly not due to a lack of investment capital. Nor is it a failure of the capacity construct. It is another broken part of the PJM system.

Capacity of the electric system really has two parts. Generation Capacity: the ability to produce a unit of energy; and Transmission Capacity: the ability to deliver a unit of the produced energy. Each is worthless without the other. There are two principal reasons that current investors in generation assets are not recovering their desired rate of return through capacity and energy revenues from recent investments and new investors are not rushing to invest in new base loaded assets. First, overbuilding of new capacity has flooded the market and supply and demand economics has forced the price of generation capacity to predictably low levels. Second, the transmission system has been studiously neglected, resulting in a failure of the "universal deliverability" concept. PJM has promoted the theory of universally deliverable generation, but has not planned and constructed the transmission system to make it a reality. If the universal deliverability concept had been honored in reality rather than in theory over the past seven years, there would be no concerns of reliability in New Jersey, the Delmarva Peninsula, or any other part of PJM.

Indeed, the entire justification of RTO formation and industry restructuring is to capture the efficiency and economics of the integrated electric system for the benefits of the end users through competitive markets. Inefficient assets should retire and efficient assets should prosper in a competitive market. But we have not built a competitive market yet. The principal broken part, the transmission system, has yet to be fixed. The lack of transmission capacity adequacy impedes the ability of efficient assets to compete with less efficient assets because they cannot be delivered to the loads who would otherwise select the more competitive asset. This is the area where FERC and state commissions should focus their efforts. Reforms to the Regional Transmission Expansion Planning Process and construction of needed transmission upgrades are the key to resolving the current transmission capacity adequacy problems. If we fail to fix this broken part, neither capacity construct changes nor any other effort will result in real improvement in the integrated electric system. To simply give more money to generation owners will result only in further increasing the current high power costs and will not assure a robustly competitive and reliable power system.

Thank you for the opportunity to present these comments.